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A COMPARATIVE EFFICIENCY ANALYSIS OF THE FCC'S PRIME TIME ACCESS RULE

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Comments on Notice of Proposed Rulemaking, MM Docket No. 94-123

by

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SUMMARY

These comments have been prepared, at the request of the Coalition to Enhance Diversity, in response to the Federal Communications Commission's Notice of Proposed Rulemaking concerning its "Prime Time Access Rule," otherwise known as PTAR.[1] We have accepted the Commission's invitation to provide "alternative frameworks to understand the public interest effects of retaining, modifying or repealing PTAR,"[2] and evaluated the rule's effects using a comparative efficiency approach. This approach goes beyond considerations of technical efficiency of production processes and industry structures to analyze contractual and organizational efficiency as well.

Utilizing the comparative efficiency approach, we find no plausible argument or evidence to support retention of the rule's off-network restriction. Whereas the off-network restriction may have once provided benefits by supporting first-run syndicators and independent stations, given the massive changes the television industry has experienced in the 25 years since PTAR was adopted, they lack any continuing justification.

We do not reach the same conclusion with respect to the network restriction, however. We find that the network restriction serves the Commission's program diversity objective by supporting non-hierarchical contracting alternatives for program production, by allowing networks and their affiliates to achieve potential collective action benefits, and by counteracting tendencies toward market foreclosure. There has been no showing that these diversity benefits are overwhelmed by any adverse efficiency effects. If anything, the recent trend toward

[1] Review of the Prime Time Access Rule, Section 73.658(k) of the Commission's Rules, FCC 94-266 (released Oct. 25, 1994) (hereafter "NPRM").

[2] NPRM, ¶59.

increased vertical control in television production and distribution makes it all the more imperative that this restriction be preserved for the time being. Given the widespread belief that the face of the television industry will continue to undergo significant changes, however, we believe that the Commission should revisit the network restriction as further significant changes take place to determine whether maintenance of this restriction continues to be warranted.

I. INTRODUCTION

The Prime Time Access Rule (PTAR), adopted by the FCC in 1970, has two features: the network restriction and the off-network restriction. The first of these prohibits network-affiliated stations in the top 50 television markets from broadcasting more than three of the four prime-time viewing hours, opening up a one-hour "access period." The off-network restriction prohibits the broadcasting of former network programs during the access period.

In analyzing PTAR, it is useful to begin with a description of the massive changes that have occurred in the television industry over the past 25 years. Section II therefore examines the industry in 1970 (when PTAR was promulgated) and in 1995 (when PTAR is being reconsidered). That completed, in Section III we develop the framework which we employ to evaluate PTAR's two restrictions.

As we interpret these two restrictions, the main purpose of the off-network restriction was to encourage entry by syndicated programmers and independent stations, while the network restriction was intended to promote affiliate programming autonomy and to encourage direct contracting between program producers and affiliated stations.

A two-part framework is therefore proposed. The first part analyzes infant industry entry effects. The second part examines the salient differences that accrue to alternative modes of contracting. We then apply this framework to the off-network and network restrictions in both 1970 and 1995.

In Section IV, we consider the argument that PTAR was designed to promote entry by independent stations, which in turn would facilitate the formation of new networks.[3] Whether net welfare gains can be ascribed to such an infant industry argument has never been shown for the television industry. As with all infant industry arguments, the basis for protection necessarily becomes progressively weaker with time. Accordingly, although the off-network restriction may have been supported by infant industry considerations in 1970, those arguments must eventually lapse. A quarter of a century later, with or without massive changes in the industry (but especially with), we judge those infant industry arguments to have expired.

The network restriction was specifically responsive to the stated goals of PTAR to "increase the level of competition in the independent production of programs, reduce the networks' control over their affiliates' programming decisions, and increase the diversity of programs available to the public" (NPRM, ¶1). The logic of this diversity argument, however, has never been spelled out. As developed in Section V, we show how the network restriction promotes contractual relationships between producers and affiliates that are different from those that would arise in the absence of this restriction. As we assess the effects of these differences, we conclude that the network restriction promotes greater affiliate autonomy and added program diversity.

In Section VI, we summarize our analysis and recommendations. We conclude that infant industry arguments, which may have been plausible for restrictions of both kinds in 1970, are without force by 1995. We further conclude that the network restriction, but not the off-network restriction, by encouraging non-hierarchical production and counteracting tendencies

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[3] "By restricting the program purchases available to top 50 affiliates during one of the prime time hours, PTAR created an advantage for independent stations and affiliates of new networks who were not subject to the same restriction by decreasing the price of off-network programming for these stations." (NPRM, ¶14)

toward market foreclosure continues to serve diversity purposes today. We therefore recommend that (1) the off-network restriction be repealed now and (2) the Commission retain the network restriction for the time being, and examine it at a later date to determine if subsequent economic developments in the television industry warrant repeal.

II. CONDITIONS OF THE TV INDUSTRY

In 1995, as in 1970, the television industry can be partitioned into three stages of production: program production, network distribution and local broadcasting. By and large, the networks act as brokers, purchasing programming from independent producers, bundling in advertising, and delivering the final product to stations. Networks own and operate some of those stations, but the bulk merely have an affiliation with the network.

Having achieved nearly complete dominance over prime time by 1970, the major three networks have experienced a declining share of television audiences. The NPRM has carefully documented this trend and several others (NPRM, ¶16-21). Here we insert a few additional details and mention several recent developments in this unfolding story. We especially take note of a significant movement in the TV industry in which networks, both established and emerging, have extended their control backward into programming and forward into local broadcasting. The result is an ever greater number of transactions taking place internal to the networks or through exclusive relationships with program syndicators and broadcast stations.[4]

[4] The re-structuring of broadcast television is not entirely the product of market forces. It must be viewed against the backdrop of the complete regulatory policy toward video media, including the Commission's Financial Interest and Syndication Rules, television ownership rules and cable television regulation.

A. Competitive Trends in Broadcast Television

In recounting increased competition for video delivery, we focus on the emergence of new broadcast networks and the appearance of alternative video delivery systems.

The growth of emerging networks has been steady, if not dramatic. Fox Broadcasting Company (FBC) was launched in March 1987 with three hours of weekend prime-time programming available over 108 stations covering 81% of the population.[5] All of the original Fox affiliates were formerly independent stations, and all but 16 were located in the inferior UHF band.[6] Seven years later, FBC had no fewer than 162 stations covering 95% of the country,[7] and of those, approximately 21 were located in the desirable VHF band.[8] Subsequently, FBC has added (or will add) 17 new VHF stations to its network.[9]

Fox does not meet the FCC's standards to be a "network" because it programs only 15 of the 22 prime-time hours. Otherwise, however, Fox appears to operate on an equal footing with the major three networks. In the past couple of seasons, Fox has matched, and in some cases exceeded, the ratings of the three major networks.[10] Furthermore, the most popular off-

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[5] Nielsen Television Index: Syndicated and Occasional Network Summary Report, 1986-87 Season.

[6] Nielsen Station Index, May 1987.

[7] Nielsen Television Index, 1993-94 Season.

[8] Nielsen Station Index, May 1994.

[9] Julie A. Zier, "Fog of war engulfs affiliation battle," Broadcasting & Cable, December 5, 1994, p.50.

[10] For the 1993-94 season, Fox surpassed NBC and tied CBS in the important demographic category of "men, 18 to 34 years old." See Nielsen Television Index: 1993-94 Season. During the 1992-93 season, FBC achieved higher ratings than NBC and CBS and was only a tenth of a point behind ABC for men, 18-34. See Nielsen Television Index: 1992-93 Season.

Fox programming now fetches top dollar in syndication against off-network programming.[11]

This year witnessed the birth of two additional broadcast networks: United/Paramount Network (UPN) and the WB network (WB). UPN debuted with 113 stations that reach 83% of the nation's homes.[12] WB began with 54 stations having 78% coverage.[13] Other specialized networks have also formed such as the Home Shopping Network, Univision, Telemundo, and most recently, the Infomall TV Network.[14]

In 1970, first-run program syndication was virtually nonexistent. Today, it is a thriving business, producing popular and profitable programs. Four distributors currently dominate first-run syndicated programming: King World, Paramount, Warner Bros. and Fox. Together they command a 98.6% nationwide share of access period syndicated programming.[15]

The viability of the emerging television networks and the success of first-run syndication depend in part on the availability of independent broadcast stations for affiliation, and also on idle cable channels as an alternative means of distribution. Since 1970, the number of full-power commercial VHF stations has increased from 508 to 559, while the number of UHF stations rose from 181 to 601.[16]

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[11] Steve McClellan, "'Bart', 'Fresh Prince' top new off-net shows," Broadcasting & Cable, 125:3, January 16, 1995, pp. 72-74.

[12] Nielsen Television Index, January-February, 1995.

[13] Nielsen, id. Note that WB accesses 18% of households nationwide through cable delivery on the superstation WGN. "UPN vs. WB," Broadcasting & Cable, 125:1, January 2, 1995, p. 36.

[14] See Julie Zier, "Paxson's IN TV: move over UPN, WB," Broadcasting & Cable, 125:4, January 23, 1995, p. 160.

[15] Nielsen Television Index, November 1994.

[16] See Broadcasting and Television Yearbook, 1970, p.8 and FCC News Release, "Broadcast Station Totals as of Dec. 31, 1994," January 24, 1995.

The appearance of alternative video delivery systems since PTAR was adopted has provided networks with growing competition for audiences. The home video cassette recorder, no more than an engineer's dream back in 1970, is a ubiquitous household appliance today, with 77.1% of all TV homes owning one or more machines.[17] $2.4 billion is spent annually on rented movies that television viewers can substitute for network offerings.[18]

Second, and equally important, is the impressive growth of cable television. In 1970, 2.5 million U.S. households subscribed to cable television service from 2,490 cable operators.[19] By January 1995, approximately 63 million U.S. households (or about 66% of the total) subscribed to cable service.[20] By then, 11,160 operators[21] carried an average of 39 channels,[22] and most of those contained programming that was exclusive to cable (i.e., not local over-the-air broadcasts, leased access channels, or distant-signal transmissions).

In the past few years, several new options for video delivery have appeared on the scene. After a shaky start, direct broadcast satellite (DBS) has gained a toehold in the video media marketplace. Three DBS services are now operating: DirecTV offers 150 channels to 350,000 subscribers, United States Satellite Broadcasting has 20 channels and Primestar has 67 channels.[23]

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[17] 1994 Statistical Abstract of the United States, Table 882.

[18] "Studio film revenues set to grow by 8.8% in 1994," Screen Finance, May 4, 1994.

[19] 1994 Statistical Abstract, id., Table 885.

[20] Nielsen Media Research, January 1995.

[21] 1994 Statistical Abstract, id., Table 885.

[22] NPRM, ¶18, footnote 30.

[23] "Cable TV ads fight satellite dish threat," Wall Street Journal, February 6, 1995, p. B6. The first two of these services are high-power DBS, while the third is a medium-powered satellite delivery system.

In addition, "wireless cable" is a new alternative technology that delivers multi-channel broadcasts over terrestrial networks. These services compete with traditional over-the-air television and with cable television in portions of the country.[24] Soon telephone companies will carry video signals to the home over their wireline networks. The FCC has now authorized phone companies to undertake nine Video Dialtone (VDT) trials.[25]

B. Growth in Vertical Control

These dramatic events shaping the television marketplace tend to overshadow the vertical restructuring that is also underway in this industry. Especially in recent years, through merger or internal expansion or long-term contract, networks have integrated backward into programming and forward into local broadcasting. Along with this restructuring, the sales relationships have grown increasingly exclusive. For these reasons, we do not agree with the Commission's assessment that "the customer-supplier relationships among [program producers, networks, affiliates, independent stations, etc.] have not changed appreciably in the last quarter century" (NPRM, ¶10).

To begin with, the networks---both established and emerging---have increased their stake in program production.[26] Prime-time programming (measured in number of series) produced by the networks in-house and broadcast over their respective affiliates grew from 13% to 31%

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[24] As of June 1994, the wireless cable industry had claimed 550,000 subscribers. NPRM, ¶18.

[25] FCC Open Meeting, February 7, 1995.

[26] A similar pattern played out in the 1980s in the cable TV industry when multiple system operators bought up cable program networks all the while expanding their ownership of local cable systems. As a consequence, in the 1992 Cable Act, Congress required the FCC to place limits on cable ownership of programming networks.

between the 1989-90 and the 1994-95 seasons. For the current 1994-95 season, it is our understanding that the three major networks and Fox combined will produce or co-produce 30% of all prime-time programs carried on the four networks. There is also a growing trend in which networks have formed joint ventures with independent producers for the supply of prime-time series.[27]

A clear example of the integration of program production and network distribution is found in the formation of the three emerging networks. Twentieth Television was essential to the building of the Fox network. It now produces or co-produces 3½ hours of prime time programming for FBC as well as several series for the three major networks. The two latest additions into network broadcasting have both adopted the Fox entry strategy: Paramount Pictures is the primary production facility for UPN, and Warner Bros. is the main program supplier for WB. UPN was launched with 4 hours of programming, two hours on each of two nights, all of which it either co-produces or produces alone (i.e., "Startrek Voyager").[28] WB began with two hours on a single night with 1½ of its 2-hour schedule co-produced by Warner Bros.[29]

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[27] An example is ABC's $100 million joint venture with Brillstein/Grey Entertainment to produce sitcoms. See David Tobenkin, "Production big business for the big three," Broadcasting & Cable, September 12, 1994, 124:37, p. 6. Very recently, Steven Bochco formed an exclusive alliance with CBS to produce television series beginning in 1997. See "Bochco signs with CBS," Broadcasting & Cable, March 1, 1995. Another sign that networks and programming interests are becoming increasingly intertwined is the announcement of a 7-year, $200 million agreement between Capital Cities/ABC and DreamWorks SKG, recently formed by Steven Spielberg, Jeffrey Katzenberg and David Geffen. This agreement apparently stipulates that the production company will produce several prime-time series for ABC and for sale to other networks. It is very possible that we would see greater studio-network integration were it not for foreign ownership restrictions that prevent companies like Sony Pictures and MCA from acquiring network-owned broadcast stations.

[28] David Tobenkin, "New players get ready to roll," Broadcasting & Cable, 125:1, January 2, 1995, p.30; Television Reviews Daily Variety, Jan. 16, 1995, p.10, Jan. 17, 1995, pp.14,18, and Jan. 23, 1995, p.20.

[29] Elizabeth Jensen, "Building a network," Wall Street Journal, January 3, 1995, p.11, Television Reviews Daily Variety, January 18, 1995, p. 30.

A second trend toward greater vertical control takes the form of expanded network participation in the broadcasting end of the business. Typically the major networks have owned and operated broadcast stations that together bump up against the ownership limits set down by the FCC. Recently, however, the networks, led by Fox, have increased their "passive interest" in station groups through acquisition of minority and nonvoting shares.[30]

In this same vein, the terms of the networks' agreements with their affiliates have become progressively more restrictive. For most of television history, affiliates have signed two-year agreements with their networks that govern program exhibition, advertising and compensation. FCC rules specified a two-year limit on the term of affiliation agreements. When this ceiling was lifted in 1989 the industry continued to renew agreements for two-year terms. Recently, however, longer agreements have been struck, and now many affiliates operate under ten-year contracts.

In compensation for the longer terms, the affiliates receive higher compensation rates for broadcasting network programming. Part of this same quid pro quo, however, gives the networks expanded rights to terminate an affiliate should the station "preempt the network feed" more than a minimum number of times without prior network approval, or if the station declines an entire program series. Some contracts now make approval for preemption more difficult, and condition compensation rates or series availability on affiliate preemption behavior.

Comparison of two ABC agreements with its WXYZ-TV affiliate in Detroit is illustrative. In 1989, ABC and WXYZ-TV signed a two-year agreement that assigned liberal

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[30] See Christopher Stern, "Small investments yield big benefits," Broadcasting & Cable, 124:42, October 17, 1994, pp. 26-28. The FCC limits the networks' non-passive ownership to a maximum of 12 broadcast stations or a 25 percent nationwide reach, whichever is reached first. 47 ***C.F.R.*** §73.3555.

rights to both parties with respect to termination of the relationship. The affiliate could terminate in response to a change in its station rate, the "weekly deduction" or the compensation percentage formula. In 1994, a ten-year agreement was signed that raised the station compensation rate by 50% (in nominal terms). Now, however, the affiliate is able to terminate the affiliation only when its annual compensation falls more than 25% below amounts specified by the compensation percentage formula. In addition, WXYZ-TV's station rate is conditional on maintaining preemption rates below previous season levels and on the clearance of ABC's *Nightline* on a "live" basis.

C. Threats to Independent Program Production

Programs that are broadcast on television come from three principal sources. First, there are the network in-house operations that produce news, sports and entertainment programs. Second, "independent producers" (which include the major film studios) supply entertainment programming such as the familiar dramas, situation comedies, made-for-TV movies and mini-series. These programs are supplied to the networks or, in some cases, syndicated directly to television stations for broadcast. Finally, local stations produce programming that they can broadcast and/or offer to the syndication market.

In the previous subsection, we documented the growth of in-house production of network programming. This trend necessarily displaces programming provided by independent programmers. In fact, during the 1989-90 season, 87% of prime-time network programming was supplied solely by independent producers. For the 1994-95 season, independent producers will provide about 69% of prime-time network broadcasts.

These figures may actually overstate the prospects for selling prime-time programming faced by new independent producers since, as mentioned above, the networks have arrangements with some of the most successful independents that gives networks exclusive rights or at least rights to a "first look" at the programs. Until a fledgling producer can establish itself, it is particularly difficult to sell into a shrinking market for independent programming.

There are also recent indications that local broadcasters have expanded their production of programming, especially local news. The increase in local news programming has been attributed to network pressure on affiliates to distinguish themselves from their rivals, and also as a survival tactic used by stations that have lost their network affiliation.[31] In any event, the result is reduced market opportunities for independent programmers.

III. THE COMPARATIVE EFFICIENCY APPROACH

A. Evolution of the Commission's Policy

It was concern over the concentration in prime time television and the shrinking volume of first-run syndicated programming that led the Commission to propose PTAR in the first place. Its distrust of agglomeration of market control notwithstanding, the Commission, in its original PTAR ruling, nevertheless appreciated how networks achieved scale economies and were able to economize on transaction costs:

> "The networks obviously have a tremendous and, we believe, insurmountable advantage in providing programs for their affiliates. Not only is there the natural tendency of an affiliate to do more business with its dominant supplier, but the program distribution process is much simpler via network. ... the syndicator is forced to make a new contract with each station for each program. Similarly, it

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[31] David Tobenkin, "New life for local TV news," Broadcasting & Cable, Oct. 10, 1994, p.68.

> is much simpler for an advertiser to make one arrangement for an entire network than to buy station by station. These disadvantages are inherent in the distribution process and not in the product." (23 ***FCC 2nd*** 386-387)

The Commission went on, however, to express a deep concern over the growth of network size and prescribed corrective action:

> "The loss of their syndication foothold over the years by independent program producers is difficult to explain on any other basis when we take into consideration the fact that most network programs are actually produced largely by outside producers. Only three organizations control access to the crucial prime time evening television schedule. ... The public interest requires limitation on network control and an increase in the opportunity for development of truly independent sources of prime time programming." (23 ***FCC 2nd*** 386-387, 394)

Public policy thinking in the 1960s and early 1970s sometimes took on a protectionist flavor. Possible economies notwithstanding, the FTC once held that it would be a violation of the merger law to permit a merger that gave the merged firm "a decisive advantage in efficiency over its smaller rivals."[32] Those views were eventually exposed as bad law and bad economics[33] and public policy is now much more deferential to efficiency--as indeed it should be.

In response to the structural problem it observed, the FCC aspired to increase the number of competitors facing the networks both in program supply and network distribution, increase the number of sources and outlets for programming, and decrease network vertical control through ownership and contractual means. The Commission did not, however, take direct structural action but worked indirectly through regulatory rules, of which PTAR is an example. In effect, the Commission chose to protect certain firms from the effects of unbridled market

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[32] In re Foremost Dairies, Inc. 60 FTC 944, 1084 (1962).

[33] Turner (1965), at p. 1324.

forces.

In its current review of PTAR the Commission questions whether the rule's restrictions "serve the Commission's 'public interest' mandate to maximize consumer welfare" (NPRM, ¶32). In particular the NPRM asks "whether any inefficiencies ... are outweighed by real benefits" (NPRM, ¶49) and seeks to avoid "uneconomical program decisions" (NPRM, ¶43). Further, the Commission expresses a desire to avoid "protecting individual competitors in the communications industry" (NPRM, ¶32) and reminds us that "the Commission's goal is, of course, to see that the public interest is served, not to maintain an inefficient distribution scheme that favors [certain competitors]"(NPRM, ¶32, n. 71).

We commend the Commission for its focus on economic efficiency this time around. Our analysis also embraces efficiency as the principal measure by which to evaluate PTAR. We feel it is necessary, however, to go beyond standard efficiency analysis, which concentrates on technical efficiency of production processes and industry structures. We explicitly recognize that classical markets are not always the efficient means to organize transactions, which leads us to assess PTAR in terms of its implications for contractual and organizational efficiency as well. In taking this approach, we have accepted the Commission's invitation to provide "alternative frameworks to understand the public interest effects of retaining, modifying or repealing PTAR" (NPRM, ¶59).

Our concern is that narrow application of the efficiency approach leads regulators to view with suspicion transactions that do not occur through simple exchange relationships. Viewed instead as a means to exercise market power by one of the bargaining parties, regulatory intervention may respond to instances of complex commercial contracting without regard to implications for inefficiency. For this reason, we also treat regulation as just another instrument for organizing transactions, and evaluate its effectiveness relative to feasible alternatives.

B. An Alternative Framework

Taking a fresh look at PTAR from the standpoint of current industry conditions, we approach the PTAR issues from a comparative efficiency perspective. This approach begins with the proposition that there are several alternative ways to organize television production. These include arms' length transactions, long-term contracts, unified ownership, and even government regulation. The various alternatives are evaluated according to their implications for economic efficiency in television program production and distribution.

We observe in this connection that any lapse in efficiency (any inefficient practice engaged in by economic agents) invites its own demise. The reason for this is that moving from a less efficient to a more efficient result always increases the size of the pie, whereupon there is more to share.

Albeit a productive point of view, it is sometimes applied in an oversimplified way. For one thing, the more efficient result that is sometimes prescribed is purely hypothetical. It is elementary that prescriptions that cannot be implemented are operationally irrelevant. Second, even as between feasible alternatives, if A is judged to be more efficient than B, but if we are now at B and there are large costs of adjustment, then remaining at B (at least for the present) may be optimal.

More generally, the comparative efficiency approach accepts that all feasible forms of organization are flawed. Markets are known to fail to achieve efficient outcomes under various conditions. In that case government intervention may be prescribed, but only if expected net gains can be projected. Below we assess the relevant considerations in the tradeoff between "market failure" and "regulatory failure" when conditions favorable to large-scale production prevail. We also compare contractual and hierarchical alternatives for transacting and their respective strengths and weaknesses. When evaluating the different alternatives for organizing transactions, it is important to remember that because conditions change, a judgment in favor of one alternative at one point in time may not carry over to a later point in time. This consideration is especially relevant for infant industry policies because protection is often problematic and its justification always expires.

C. Market Failure vs. Regulatory Failure

Although markets can fail in a variety of ways, those that concern us here are (1) natural monopoly and (2) the intended (i.e., strategic) and unintended (i.e., byproduct) spread of distortions caused by natural monopoly. These distortions affect adjacent markets, either forward into distribution or backward into supply.

Natural monopoly (or oligopoly) refers to the condition where economies of scale are large in relation to the size of the market, whence the market can support only one (or a few) efficient-sized firm(s). It was common back around 1970, for instance, to describe the network stage of the television industry as being made up of 2½ networks, where ABC was the marginal ½ network. The fear in this situation is that successful firms will abuse the market power conferred by their large size. Although one "solution" to a natural monopoly condition is to break up large firms, this would come at a cost of lost economies through small-scale production.

Firms with monopoly power can also use this power strategically to exercise control over and/or deter entry into related stages of production. Moreover, even if this is not done in an overt way, firms that are contemplating entry into related stages may nevertheless perceive potential hazards. Whether it is intended or not, therefore, natural monopoly at one stage can, by reason of entry deterrence, have spillover effects into another stage.

Regulation is often prescribed as a means by which to deal with natural monopoly. One possibility is to subject the firm to rate-of-return regulation. A second is to impose rules that limit the degree of spillover.

The FCC plainly did not wish to impose rate-of-return regulation on the television industry. As we interpret PTAR, however, one of the FCC's purposes was to encourage independent entry into both the program production and broadcast sectors of the industry, neither of which was subject to natural monopoly, but both of which were subject to spillover. So construed, PTAR afforded a degree of infant industry protection.

Regulation is also subject to failures, however. Social net gains are possible only if the failures of regulation (the cure) are not worse than the failures of the market (the disease). Among the failures of regulation are those that are due to misperceptions about (1) the implied tradeoffs and (2) the mechanism through which the regulations work. Also, intertemporal failures, whereby regulation (3) takes on a life of its own and/or (4) serves redistribution purposes of an unintended kind, sometimes arise.

Misperceptions about tradeoffs are sometimes due to myopia, in that delayed and indirect effects are neglected in relation to direct and immediate effects. The neglect of the delayed and indirect costs (e.g., investment disincentives) as against immediate benefits (e.g., protection) is an example.

Misperceptions about mechanisms sometimes arise by neglecting to examine the processes through which the regulations work in sufficient micro-analytic detail. Intuitions about the effects of regulations may therefore be underdeveloped and/or incorrect by failure to trace out the contractual and other consequences of regulations in a detailed and comparative way.

The idea that regulation has a life of its own makes allowance for intertemporal changes in the relation between the regulatory agency and the industry. The condition sometimes referred to as "regulatory capture" is an example.[34] While we do not suggest that the Commission has been captured by the television industry, regulations such as PTAR create vested interests that resist any change in the regulations--even if the initial "concerns" at which the regulation was directed have long since been abated. Any proposal to regulate should therefore make allowance for these propensities to preserve regulation beyond the interval to which "intended benefits" can reasonably be ascribed.

Finally, regulations often give advantages to one set of industry participants in relation to others. We will argue (in Section V.B) that at this time the off-network restriction serves no efficiency purpose but continues to redistribute wealth to certain industry players.

D. Contractual Failure vs. Hierarchical Failure

The polar forms of economic organization are arms-length contracting (according to which each party maintains its autonomy) and hierarchy (according to which one party complies

[34] Bernstein (1955).

with the "orders" of another). Autonomous parties have strong incentives to keep down costs, to innovate, and otherwise to respond to their opportunities. Hierarchy has the advantage of moving the two stages (or possibly multiple parts) in a coordinated way. Incentives, however, are compromised in the process.

The weak incentives that accrue to hierarchical organization give rise to added bureaucratic practices and added bureaucratic costs. Sometimes those are the unavoidable costs of improved coordination---and plainly, coordination plays a key role in network television broadcasting.

A better result can sometimes be realized, however, by attenuating hierarchy in a manner that preserves the main benefits of coordination yet permits the parties to exercise a limited degree of autonomy. In that event, the need is to ascertain whether a better balance can be struck between the failures of markets (which are responsible for poor coordination between parties) and the failures of hierarchy (which give rise to excesses of bureaucratic control and cost). This balance is addressed in Section V.

* * * * *

The factors that are most pertinent to an assessment of PTAR (both in 1970 and again today) are: (1) the relation between purported market failures and the conditions of entry and (2) the relative performance of contracting and hierarchy. The "infant industry theory," mentioned in the NPRM (¶14, n. 18) as a justification for PTAR, is the focus of our analysis of entry in Section IV. The lens of comparative contractual analysis, especially as it bears on diversity, is then applied to PTAR restrictions in Section V.

IV. ENTRY ANALYSIS

According to the infant industry theory, faced with the difficulty of competing with incumbent firms, entrants may be unable to grow to a size sufficient to realize economies in their operation.[35] For instance, the Network Inquiry (1980) mentioned the possibility that emerging networks may require time to acquire programming expertise before they can sustain a viable program lineup. So-called "positive feedback effects" may also be operating in network television. These would arise when small networks have difficulty attracting affiliates because stations prefer to join a larger network. Their preferences are fully justified assuming only large networks can sustain the cost of high-quality programming and can attract national advertisers.

When faced with an infant industry, so the theory goes, policy makers should aid the fledgling firms in the hope that they may grow to a size sufficient to be self-sustaining. After that time, they begin to pay dividends in the form of lower prices and improved quality and variety. This can be accomplished either by subsidizing the infant firms, or by handicapping incumbents.

The difficulty with infant industry protection is that too often it is indiscriminately applied as policy makers fail to establish that industry conditions warrant such protection. Moreover, whatever the justification for an infant industry argument at the early stages of an industry's development, there is one verity: infant industry arguments cannot justify perpetual protection. Firms that enter an industry with the benefit of special protection should be expected to build up the requisite resources and capabilities and to become viable competitors. At the expiration of the startup interval, new entrants will find ways to make it on their own or they will be

[35] Several different efficiency explanations for infant industry protection are given in Grossman (1990).

acquired by others. Otherwise they should exit.

Although the PTAR record is not altogether clear with reference to an infant industry purpose, we find suggestions in the record that this was an intended purpose. Furthermore we believe that plausible arguments of that kind can be advanced. Arguably, both PTAR restrictions could have the intended effects of assisting various infant firms including independent stations and producers and syndicators of first-run syndicated programming.[36] An infant industry rationale for the off-network restriction seems to be especially plausible.

PTAR's off-network restriction helped marginal independent stations in the largest 50 markets to broadcast off-network programs against non-network fare on the network affiliates during the access period. To be sure, that is only one hour of the program day. It is, however, one of the four prime time hours and had added revenue significance on that account.

Note, however, that the access period did not guarantee that marginal stations would make it, and some did not. Many stations, however, with good business plans and good management got across the threshold and learned to cope. Once established, such stations should be expected to carry their own weight. Put differently, commercial stations for which assistance might have been judged to be appropriate in 1970 should not remain on welfare in 1995--even if the industry in 1995 were unchanged. Significantly, however, the industry has undergone vast changes in the intervening years (see Section II, above). There is not, therefore, a continuing need to protect independent stations today.

[36] To different degrees, both restrictions improve independent stations' ability to attract audience during the access period. First-run syndicators are helped by both restrictions since they open up a market for their products. First-run syndicators benefit by being able to sell into the access period without competition from network and off-network programming. On the other hand, the off-network restriction may hurt independent programmers by reducing demand for network prime-time programming.

The network restriction applies principally to relations between the networks and their affiliates. Since the network is precluded from programming the access period, another infant industry effect of PTAR was to increase the demand for first-run syndicated programming, thereby making otherwise marginal producers of such programming more viable.

Symmetrical application of the above reasoning leads to a symmetrical result: whatever the infant industry protection that was afforded to (and possibly justified for) marginal producers by the rule in 1970, it has since expired. Indeed, in Section II we clearly demonstrate that two principal recipients of protection---independent stations and first-run syndicators---have reached maturity since PTAR was adopted. The upshot is that we judge any infant industry justification for PTAR to have lapsed during the quarter of a century that has passed since the rule was adopted.

V. CONTRACTUAL ANALYSIS

There are many ways to skin a cat; and there are many ways to organize economic activity. Some ways of skinning cats are better than others. Some ways of organizing are better than others.

Of the variety of ways to organize, the two polar types are markets (autonomous contracting) and hierarchy (unified ownership, working through administration). Except where close cooperation between successive stages of economic activity is needed, especially in conjunction with specialized investments made by one or both parties, there are incentive and aggregation advantages in working through markets.

One way to organize is for all three stages in the television industry---the producers, the